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No. 04-181

IN THE

Supreme Court of the United States

IRVING PULP & PAPER, LIMITED d/b/a IRVING PAPER,

Petitioner,

v.

CAPITAL FACTORS, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION OF TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA, THE EVERETT HERALD, THE REGISTER GUARD, THE SEATTLE TIMES CO., THE WALLA WALLA UNION BULLETIN, AND THE YAKIMA HERALD REPUBLIC FOR LEAVE TO FILE BRIEF *AMICI CURIAE* IN SUPPORT OF PETITION AND BRIEF *AMICI CURIAE*

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MOTION FOR LEAVE TO FILE BRIEF

Pursuant to Rule 37.2 of the rules of this Court, *Amici Curiae* Travelers and Surety Company of America ("*Travelers*"), the Everett Herald, the Register Guard, The Seattle Times Co., the Walla Walla Union Bulletin, and the Yakima Herald-Republic (together, "*Newspapers*" and with Travelers, "*amici*") hereby move for leave to file a brief *amicus curiae* in support of the petition for a writ of *certiorari* filed by Irving Pulp Paper, Limited d/b/a Irving Paper ("*Irving Paper*").*

As more fully explained in the accompanying brief, each of the *amici* had commercial relationships with Kmart Corporation ("*Kmart*") prior to the commencement of its chapter 11 bankruptcy. After filing for bankruptcy protection, Kmart was in immediate need of trade credit and surety bond capacity.

The *amici* agreed to continue their relationships with Kmart through credit transactions by which the Newspapers rendered advertising and distribution services on favorable terms and Travelers and other sureties provided financial accommodations to Kmart in the form of surety bonds. In consideration for the trade credit and financial accommodations, Kmart provided for priority treatment and payment of certain prepetition claims and, for the sureties, provision of collateral.

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* Petitioner Irving Paper consented to the submission of the accompanying brief. Capital Factors, Inc. declined to extend its unconditional consent to the filing of the accompanying brief.

After notice and a hearing, these credit transactions were approved by orders of the bankruptcy court that were not subject to any stay. The orders were fully implemented and the credit transactions consummated. In the end, thousands of creditors, including *amici*, extended billions of dollars of postpetition trade credit and financial accommodations to Kmart in reliance on the approval orders.

Pursuant to section 364(e) of the Bankruptcy Code, *amici* and other creditors were entitled to rely on the effectiveness and protections of those approval orders, free from the uncertainty of appellate review. 11 U.S.C. § 364(e). As a result of the decision below, creditors were deprived of the benefit of their bargains and the protections Congress afforded to encourage them to provide credit to debtors. The appeals of the approval orders should have been dismissed. Instead, the court of Appeals for the Seventh Circuit has deepened the conflict among the circuit courts and burdened the administration of the bankruptcy laws with inequity and uncertainty. Review of the lower court decision is warranted.

The petition filed by Irving Paper provides a compelling basis for granting a writ of *certiorari*. The accompanying brief will assist the Court in determining whether to grant *certiorari* because: (1) *amici* can more broadly inform this Court of the enormous inequity, uncertainty, and burdens engendered by the lower court's decision; (2) the accompanying brief addresses additional points to provide substantial support for Irving Paper's petition; and (3) *amici* speak to the inequitable and onerous adverse consequences of the lower court's decision on future chapter 11 cases.

Accordingly, *amici* respectfully request that the Court grant leave to file the accompanying brief *amicus curiae*.

Respectfully submitted,

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BRIEF OF THE *AMICI CURIAE*

Amici Curiae Travelers Casualty and Surety Company of America ("*Travelers*"), the Everett Herald, the Register Guard, The Seattle Times Co., the Walla Walla Union Bulletin, and the Yakima Herald Republic (together "*Newspapers*") submit this brief in support of the petition filed by Irving Pulp & Paper, Limited d/b/a Irving Paper ("*Irving Paper*") for a writ of *certiorari* to the United States Court of Appeals for the Seventh Circuit.[1]

STATEMENT

This matter arises out of the chapter 11 reorganization of Kmart Corporation and certain of its affiliates and subsidiaries ("*Kmart*").

Prepetition Relationships

Prior to Kmart's filing for bankruptcy, the Newspapers were critical vendors who rendered advertising and distribution services as part of Kmart's extensive advertising and weekly circular distribution program which generated $11 billion of Kmart's annual sales.

Prior to Kmart's filing for bankruptcy, Travelers and other sureties issued surety bonds to secure the financial requirements of Kmart and without which Kmart could not lawfully engage in certain businesses or obtain essential services in numerous states.

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1. This brief has been authored in its entirety by undersigned counsel for the *amici curiae*. No person or entity, other than the named *amici* and their counsel, made any monetary contribution to the preparation and submission of this brief.

Credit Transactions

Upon the commencement of its chapter 11 bankruptcy cases, Kmart required immediate access to credit and continuation of its surety bond programs in order to continue its operations.

After the bankruptcy filing, the Newspapers agreed to continue to render their vital services to Kmart on the same trade (credit) terms as Kmart enjoyed prior to its bankruptcy for a period of at least two years and to waive liens and limit reclamation claims, if any.

For their part, Travelers and other sureties agreed to rescind prepetition cancellation notices on certain bonds, reinstate and renew certain bonds, and issue new bonds, all in accordance with their applicable surety bond programs.

In consideration for these benefits Kmart agreed to provide the following: (a) for the Newspapers, Kmart agreed to treat the prepetition claims as administrative expenses and pay them; and (b) for Travelers and the other sureties, Kmart agreed to pay prepetition obligations backed by surety bonds, acknowledge certain priority treatment for the claims of sureties, and provide collateral to secure Kmart's obligations under the surety bonds and related indemnity agreements.

The Bankruptcy Code broadly authorizes debtors to obtain credit or incur debt. 11 U.S.C. § 364. The statute does not prescribe or limit the terms of the credit transactions but does requires in almost all instances (other than transactions in the ordinary course of business) bankruptcy court approved after notice and hearing. Transactions for the provision of trade credit between Kmart and the Newspapers is certainly

within the ambit of section 364. *See Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A*, 530 U.S. 1, 12 (2000); *In re Statmore*, 177 B.R. 312, 313-14 (Bankr. D. Neb. 1995) (advertising and telephone services).

On January 25, 2002, after notice and a hearing, the bankruptcy court approved Kmart's proposed form of credit transaction and entered its corresponding order ("*Vendor Order*"). Likewise, by order entered on March 22, 2002 ("*Surety Order*"), the bankruptcy court approved the continuation of the surety bond programs. It cannot be gainsaid that the transactions approved by the Vendor Order and the Surety Order—the extension of trade credit and the provision of financial accommodations—fit firmly within the ranks of section 364 transactions; accordingly, the parties to those transactions are entitled to the protections of section 364(e).

The Vendor Order and Surety Order were implemented and the credit transactions authorized by them were consummated. Pursuant to the Vendor Order, the Newspapers rendered vital advertising and distribution services on credit terms to Kmart and afforded Kmart the certainty that its extensive advertising program, critical to the ongoing health of its business, would continue on favorable credit terms. In consideration for the extension of postpetition credit, the Newspapers were paid, as administrative expenses, the amount of their prepetition claims.

Pursuant to the Surety Order, Travelers and other sureties reinstated and renewed prepetition bonds and continued their surety bond programs without which Kmart could not do business or obtain services or lawfully operate in numerous states. In consideration for such financial accommodations,

Kmart paid surety-backed obligations, accorded certain surety claims priority treatment, and secured certain surety-related obligations with collateral.

To enhance a debtor's ability to promptly obtain necessary credit and thus facilitate its policies of successful rehabilitation and preservation of going concerns, Congress provided comprehensive protection to creditors who extend credit in good faith by insulating their approved credit transactions from reversal or modification on appeal unless a stay of the order approving the credit transaction is imposed:

> [T]he reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, of a grant under this section of a priority or lien, does not affect the validity of any debt so incurred, or any priority or lien so granted . . . unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.

11 U.S.C. § 364(e).

Appeal

Meantime, on February 1, 2002, without seeking or obtaining a stay, Capital Factors, Inc. ("*Capital*") took an appeal from the Vendor Order. An appeal (again without stay) was taken from the Surety Order but was later resolved without appellate review. Over fourteen months later, on April 8, 2003, the district court reversed the Vendor Order and overturned the credit transactions approved by that order. *Capital Factors, Inc. v. Kmart Corporation*, 291 B.R. 818 (N.D. Ill.).

The district court determined that approval of the component of the credit transaction providing for the payment of critical suppliers' prepetition claim amounts in exchange for postpetition credit was erroneous. Regarding the mootness of the appeal due to substantial consummation of the credit transactions and payment of vendors' claims, the district court stated that Capital was not required to obtain a stay to preserve its appellate rights. 291 B.R. at 823. Further, the district court excused Capital's failure to obtain a stay, speculating that a motion to stay would not likely have been granted by the bankruptcy court. However, the district court ignored Capital's unexercised ability to bring a stay motion in the district court. *See In re Forty-Eight Insulations, Inc.*, 115 F.3d 1294, 1298 n.3 (7th Cir. 1997); Fed. R. Bankr. P. 8005 (motion for stay pending appeal "must ordinarily be presented to the bankruptcy judge in the first instance").

By its decision dated February 24, 2004 ("*Kmart Decision*"), the Seventh Circuit affirmed the district court's order reversing the Vendor Order. The circuit court unbundled the credit transaction, determining that section 364(b) authorized Kmart to obtain unsecured postpetition credit or to incur unsecured debt, but that the price for such credit in the form of administrative expense priority for prepetition claim was impermissible. *In re Kmart Corp.*, 359 F.3d 866, 872 (7th Cir.).

The circuit court acknowledged that section 364(e) prohibited "revision of transactions completed under judicial auspices" and cited DIP financing orders as entitled to such protection. *Id.* at 869. In this, the Seventh Circuit Court reiterated its prior observation that under section 364(e) "a lender that extends credit in reliance on a financing order is entitled to the benefit of that order, even if it turns out to

be legally or factually erroneous." *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1355 (7th Cir. 1990). Nonetheless, having unbundled the Vendor Order credit transaction, the circuit court held that section 364 and its protections do not apply where a creditor's grant of postpetition credit is provided in consideration for the priority treatment of certain prepetition claims and the payment of those claims as administrative expenses. 359 F.3d at 872.

The circuit court also acknowledged that reversing the Vendor Order would result in actions by Kmart to recover the payments made to critical vendors, oblivious to its earlier observation in *Kham & Nates* that depriving lenders of the certainty of their transactions will deter lending to debtors:

> [B]ankruptcy judges may make *lending* commitments to give priority to new credit. If creditors fear that the rug will be pulled out from under them, they will hesitate to lend. So § 364(e) . . . disable[s] courts from backtracking on promises in the absence of bad faith, which is a very narrow exception.

908 F.2d at 1355 (emphasis in original, citations omitted).

Rejecting section 364 as a source of authorization to the portion of the credit transaction providing for administrative expense status and payment, the circuit court then examined whether the payment was authorized under section 363(b)(1) under which a debtor "may use, sell, or lease, other than in the ordinary course of business, property of the estate." The Court concluded that the Vendor Order was "unsound" under section 363(b)(1), but having introduced the alternative

section 363 analysis, the Court failed to consider whether section 363(m), a companion provision to section 364(e), might appropriately prohibit appellate courts from depriving creditors of protections previously approved by a prior court order.

> Several provisions of the Bankruptcy Code of 1978 provide that courts should keep their hands off consummated transactions. For example, 11 U.S.C. § 363(m) says that reversal of an order authorizing the sale or lease of property of the estate "does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith. . . . " Unless the sale is stayed pending appeal, the transaction survives even if it should not have been authorized in the first place.

In re UNR Industries, Inc., 20 F.3d 766, 769 (7th Cir. 1994).

As the Seventh Circuit forecast, Kmart has commenced thousands of lawsuits to recover hundreds of millions of dollars paid to vendors in exchange for their agreement to provide critically important goods and services on favorable credit terms. As a result, vendors who provided credit in reliance upon the Vendor Order are now being deprived of the protections afforded by section 364(e) and are being stripped of their benefits.

REASONS FOR GRANTING THE PETITION

I.

The Decision Of The Court Of Appeals For The Seventh Circuit Deepens A Mature And Irreconcilable Conflict Among The Courts Of Appeals On The Issue Of Whether And To What Extent Bankruptcy Code Section 364(e) Protects An Order Approving A Credit Transaction From Subsequent Appellate Modification

By the Kmart Decision, the Seventh Circuit deprives creditors of the benefit of their postpetition credit transactions and the protection of section 364(e) which would otherwise insulate such court-approved transactions from appellate reversal. It deepens a mature and irreconcilable conflict among the Courts of Appeals.

The Sixth and Ninth Circuits have concluded that section 364(e) protects from appellate reversal or modification a credit transaction approved by the bankruptcy court and for which no stay has been obtained. *See Burchinal v. Central Washington Bank* (*In re Adams Apple, Inc.*) 829 F.2d 1484 (9th Cir. 1987); *Unsecured Creditors' Comm. v. First Nat'l Bank & Trust Co.* (*In re Ellingsen MacLean Oil Co.*), 834 F.2d 599 (6th Cir. 1987); *see also Boullioun Aircraft Holding Co., Inc. v. Smith Mgmt.* (*In re Western Pacific Airlines, Inc.*), 181 F.3d 1191 (10th Cir. 1999) (following *Adams Apple*).

Both circuits view section 364 as a broad mandate to induce postpetition extensions of credit to the bankruptcy estate while neither prescribing nor proscribing permissible terms of the credit transaction.

Thus in the Ninth Circuit's view, section 365 authorizes bankruptcy courts to permit the use of a variety of financial devices, including priority treatment of a creditor's prepetition claim. *In re Adams Apple*, 829 F.2d at 1488.

Likewise, in *Ellingsen*, the Sixth Circuit evaluated a credit transaction as a whole package, including an agreement to forego a challenge to prepetition liens, and determined that the credit transaction was authorized under section 364. *In re Ellingsen*, 834 F.2d at 602.

Cognizant of the congressional intent to promote investment in businesses in bankruptcy, both circuits view their appellate role in narrow terms.

In the absence of a stay pending appeal, the appellate court will uphold a credit transaction between a debtor and a good faith creditor that falls within the broad intent of section 364, even if bankruptcy court approval was erroneous.

In sharp contrast, the Eleventh Circuit has construed the protections of section 364(e) more narrowly and rejected the reasoning of the circuit courts in *Adams Apple* and *Ellingsen*. *Shapiro v. Saybrook Mfg. Co.* (*In re Saybrook Mfg. Co.*), 963 F.2d 1490, 1493 (11th Cir. 1992). In *Saybrook*, the circuit court held that section 364(e) does not protect a credit transaction in which a lender's prepetition claim is accorded priority treatment in exchange for a postpetition extension of credit. *Id.* In its Kmart Decision, the Seventh Circuit has joined the Eleventh Circuit, depriving creditors of the benefit of their credit transactions with debtors after determining that a component of the transaction is not permitted under section 364.

The Third Circuit compounds this conflict among the circuit courts by espousing yet another view of the protections of section 364(e). Notwithstanding a creditor's good faith and the absence of a stay pending appeal, the Third Circuit holds that a bankruptcy order approving a section 364 credit transaction may be modified so long as the credit transaction has not been fully consummated. *The Resolution Trust Corp. v. Swedeland Dev. Group, Inc.* (*In re Swedeland Dev. Group, Inc.*), 16 F.3d 552 (3d Cir. 1994). The Third Circuit acknowledges its disagreement with the Ninth and Sixth Circuits. *Id.* at 562.

These divisions among the circuit courts are of long-standing and acknowledged by the courts themselves. The conflicting circuit courts' views concerning whether and to what extent section 364(e) protections are available warrant review by this Court to resolve the conflict.

II.

Certiorari Is Further Warranted Because Resolution Of The Conflict In The Lower Courts Over The Question Presented Is Vital To The Orderly Administration Of The Bankruptcy Laws

Credit transactions are approved in virtually every chapter 11 case. Orders concerning critical vendors are now a mainstay in nearly every major chapter 11 reorganization.

In the Kmart case alone, thousands of creditors extended billions of dollars of credit pursuant to credit transactions that were approved by the bankruptcy court.

The Vendor Order approving the credit transactions was not stayed and was fully implemented. The credit transactions were consummated by creditors acting in good faith and in

reliance on the comprehensive protection afforded by the plain language of section 364(e).

The Kmart Decision deprives these creditors of the protections upon which they relied and subjects them to lawsuits and the disgorgement of hundreds of millions of dollars years after they had fully performed their part of the bargain and extended credit to a newly-filed chapter 11 debtor in need of credit to operate and to promote a successful reorganization.

The inequity to these creditors in the Kmart case is manifest. The detrimental impact on future bankruptcy cases is predictable. If this Court does not review and reverse the Kmart Decision, creditors will be far less likely to do business with debtors, an outcome decidedly at odds with the goal of chapter 11 to promote reorganization. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1983).

CONCLUSION

For the foregoing reasons, the writ of certiorari should be granted.

Respectfully submitted,

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